



# Taking Too Much Depreciation?

By:

Laura Strombom, EA, MBA, NTPIF, ELP

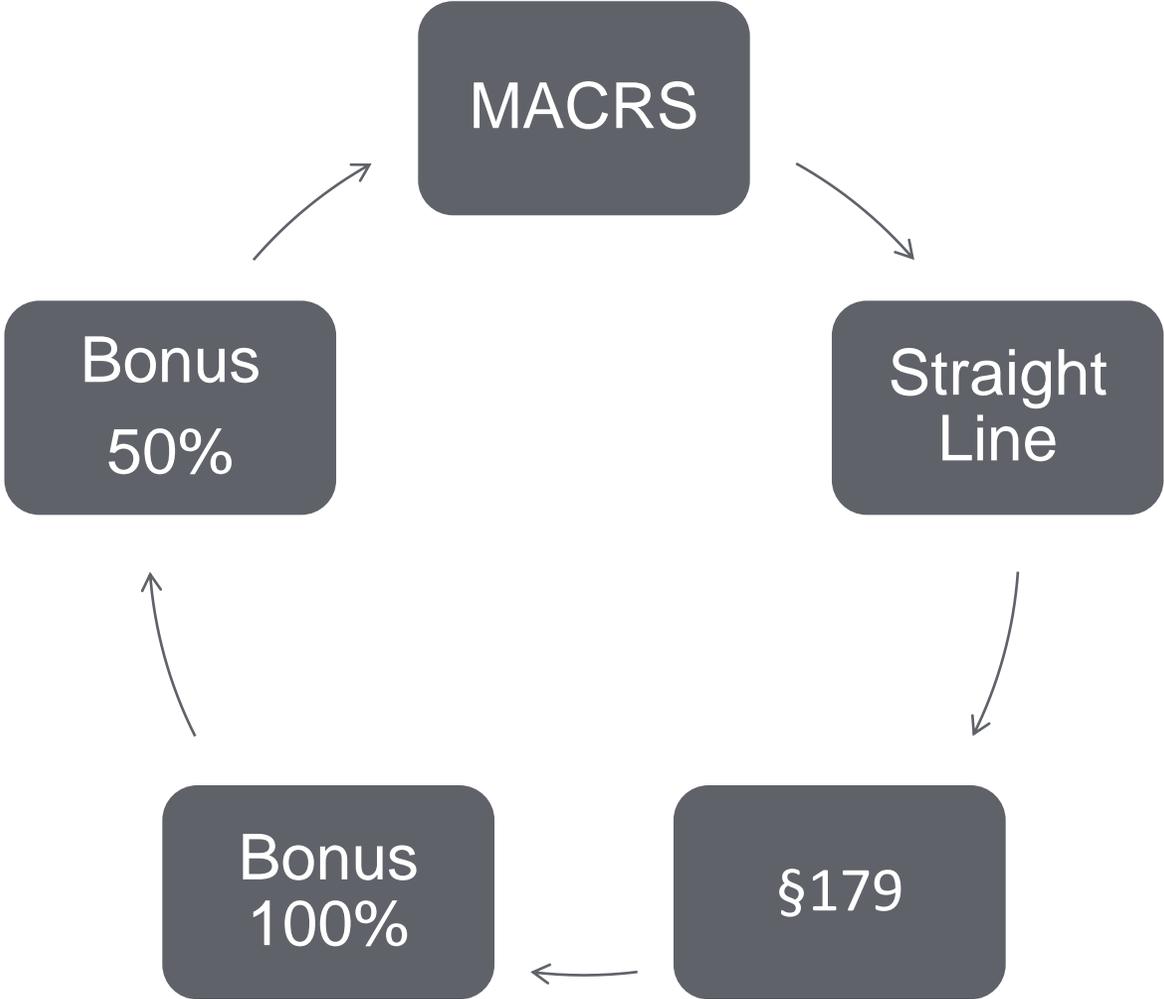
For

National Association of Tax Professionals (NATP)

# Course Description

The Tax Cuts and Jobs Act of 2017 (TCJA) has provided dramatic increases in the ability to expense depreciable business assets under Code Section 179 and bonus depreciation. TCJA also has introduced the qualified business income deduction which rewards profit in contrast to the increased expensing options which reduce profit. These competing provisions provide challenges, as well as opportunities for practitioners when advising their clients.

# Depreciation



# §179 Expensing Election

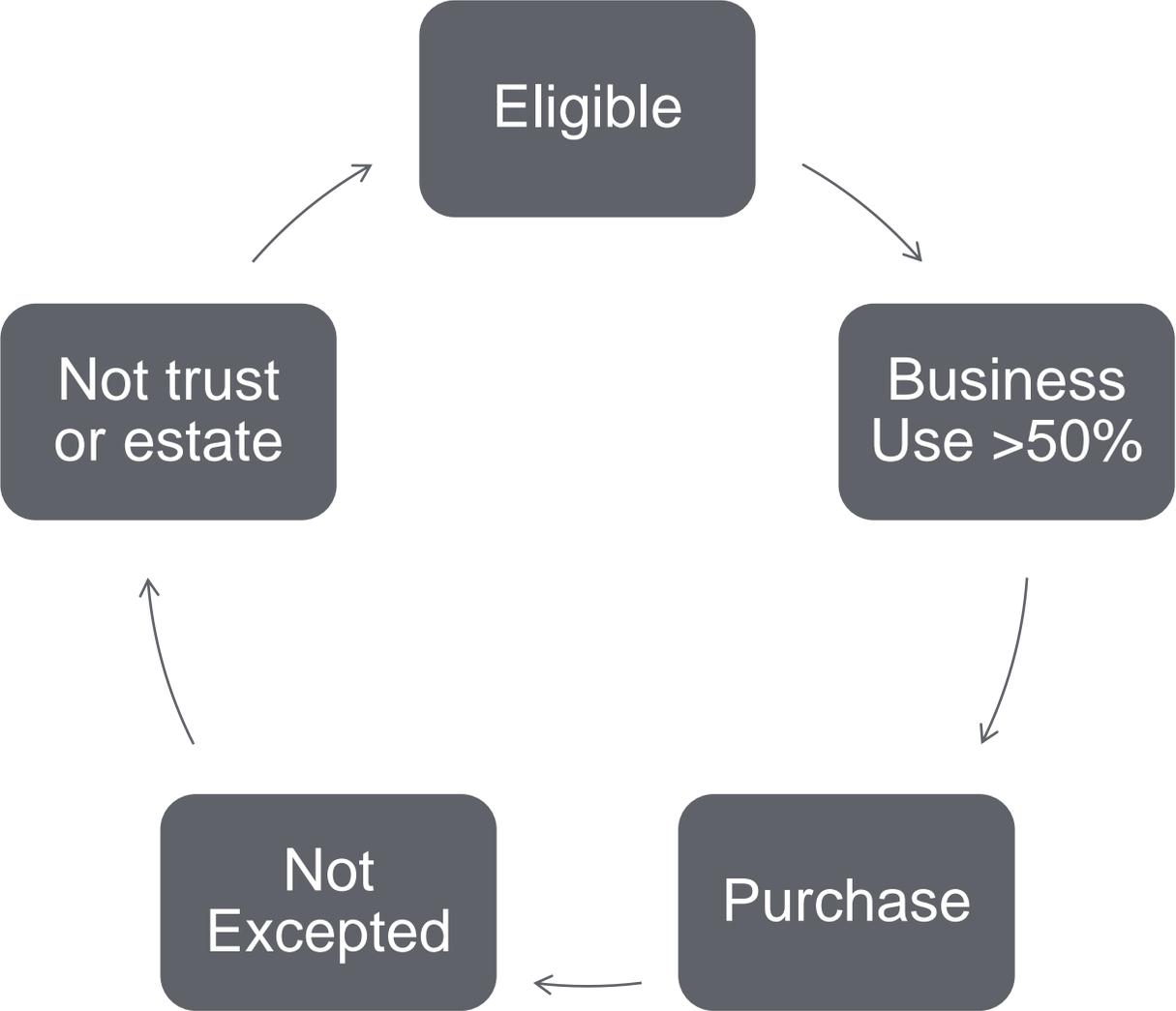
- General Information
  - Can elect to use in years with high gross income
  - Can lower income tax bracket
  - Reduces self-employed taxpayer's SE taxable income
  - Foregoes future depreciation (UNLESS not enough income to use of all deduction in current year)

# §179 Expensing Election

	2018
Maximum overall §179 deduction	\$1,000,000
Maximum §179 deduction for an SUV with a GVWR more than 6,000 pounds but not more than 14,000 pounds*	\$25,000
Phase-out begins when §179 property exceeds	\$2,500,000

*\*Indexed for inflation starting 2019*

# Qualifying Property



# Business Income Limitation

- Deduction cannot exceed business income, which is
  - Income from any and all of taxpayer's businesses (including spouse's income if MFJ)
  - Income from taxpayer's meaningful participation in business operations
- Net income from trade or business also includes:
  - §1231 gains or losses
  - Interest from working capital of the trade or business
  - Compensation earned as an employee (W2 tied to the business)

# Bonus Depreciation

Placed in Service Year	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	Longer Production Period Property and Certain Aircraft
<b>Portion of Basis of Qualified Property Acquired after Sept. 27, 2017</b>		
9/28/17 – 12/31/22	100%	100%
2023	80%	100%
2024	60%	80%
2025	40%	60%
2026	20%	40%

# Bonus Depreciation Property



# Claiming Bonus Depreciation



# Net Operating Loss

- No longer an option to carryback (other than certain farm losses)
- After 12-31-17, NOL deduction is limited to 80% of the taxable income for losses beginning in taxable years after 12-31-17
- Cap of 20 years for carryforwards removed – now unlimited



# Excess Business Loss (EBL)

- In addition to 20% of taxable income, business losses are also limited to \$250,000 / \$500,000 MFJ
- More simply put: the loss cannot offset other income in excess of these limits.

# EBL Example 1

- Autumn Fall is single. Her schedule C shows a loss of \$300,000
- Autumn has \$350,000 in wage income
- Autumn's maximum business loss that can offset her income is...
- \$250,000
- Autumn's EBL of \$50,000 is added back on Schedule 1 line 21 with the notation ELA
- Autumn's taxable income is  $\$100,000 - \$12,000 = \$88,000$
- Autumn still pays the additional Medicare tax on the \$150,000 over her \$200,000 in wages of \$1,350
- Autumn carries the \$50,000 forward as a post-2017 NOL
- She also carries the \$300,000 forward for QBID purposes

# Section 199A

- Up to 20% of QBI taken as a reduction of taxable income net of LTCG
- Does not reduce SE tax
- Limits based on W2 wages and Qualified Property (QP) values
- Not allowed for certain professions – SSTB
  
- BUT if taxable income is below thresholds there are no limits based on wages, QP values, or profession
- 2018 thresholds \$157,500 - \$207,500 (X2 for MFJ) (\$315,000 - \$415,000)
- Thresholds adjusted for inflation annually

# Qualified Business Income: QBI

- QBI means the net amount of qualified gain, deduction, and loss with respect to any trade or business
  - Does not include qualified REIT dividends, qualified cooperative dividends or PTP income (these are separate)
  - Effectively connected with the conduct of a trade or business in the United States
  - Included or allowed in taxable income for the year
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# Section 199A Limitation Exclusions

- Taxable Income Thresholds for phase-in limits/phase-out allowance
  - MFJ \$315,000 to \$415,000
  - All others \$157,500 to \$207,500
- Below thresholds - No limits apply
- Caps applied after phase-in of limits
  - W2 50% total or
  - W2 25% +2.5% unadjusted basis in assets
- SSTB Profession – no QBI after phase-out of deduction

# QBID Basics for Calculations

- Determine business profit
- Determine taxable income net of anything taxed as LTCG (long term capital gains)
- Which of these is lower
  - The lesser of these two x 20% is Qualified Business Income Deduction Maximum
- If taxable income is below thresholds – DONE

# Calculating QBID

- Tax Professional, Single
  - Schedule C
  - Profit \$50,000
  - W2 second job \$30,000
  - No LTCG
  - Taxable Income \$48,000
- Which is smaller, profit or taxable income?
- 20% of \$48,000 = \$9,600 This is QBID

# Putting it all Together

- Alpha Beta, Owner-Operator Truck Driver, 39 years old
- Single, no dependents
- Standard Deduction (\$12,000 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- Purchases new truck tractor for \$165,000 1-1-18
- Without ANY depreciation:
  - AGI: \$61,035
  - QBID: \$9,807
  - Taxable Income: \$39,228
  - Income Tax: \$4,569
  - SE Tax: \$9,280
  - Total Tax Liability: \$14,849

# Default Depreciation – 100% Bonus

- Truck Tractor is 3 yrs MACRS Property
- 100% Bonus Depreciation: \$165,000
- Business Income: <\$99,325>
- AGI: <\$99,325>
- QBID: \$0
- Taxable Income: \$0
- Income Tax: \$0
- SE Tax: \$0
- Total Tax \$0
- BUT for 2019...?

# Carryovers to 2019

- Post 2017 NOL: <\$99,325>
- Qualified Business Income Deduction Carryforward: <\$99,325>

# 2019 – NOL Computation

- Standard Deduction (\$12,200 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Depreciation left on truck tractor
- Post 2017 NOL: <\$99,325>
  - Can only reduce 80% of income tax calculated without regard to NOL
  - Pre-NOL AGI: \$61,035 (\$65,675 less ½ SE Tax)
- QBI: \$65,675 + <\$99,325> = <\$33,650>
  - QBID = \$0
- Taxable Income before NOL: \$61,035 less Standard Deduction less QBID
  - \$61,035 – \$12,200 - \$0 = \$48,835
- Taxable Income after NOL
  - Allow 80% of taxable income for NOL
  - \$39,068 NOL allowed
- Taxable Income = \$9,767

# 2019 Taxes

- Taxable Income: \$9,767
- Income Tax: \$977
- SE Tax: \$9,280
- Total Tax Liability: \$10,257

# Carryovers to 2020

- NOL: \$99,325 less \$39,068 = \$60,257
- Qualified Business Net Loss Carryforward: \$33,650

# 2020 NOL Computation

- Standard Deduction (\$12,400 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Depreciation left on truck tractor
- Post 2017 NOL: <\$33,624>
  - Can only reduce 80% of income tax calculated without regard to NOL
  - Pre-NOL AGI: \$61,035 (\$65,675 less ½ SE Tax)
- QBI: \$65,675 - \$33,650 = \$32,025
- QBID: 20% of \$32,025 or 20% of \$48,635
- QBID: \$6,405
- Taxable Income before NOL and QBID: \$61,035 less Standard Deduction less QBID
  - $\$61,035 - 12,400 - \$0 = \$48,635$
- Taxable Income after QBID:  $\$48,635 - 6,405 = \$42,030$
- Taxable Income =  $\$42,030 - (80\% \text{ of } \$42,030 = \$33,624) = \$8,406$

# 2020 Taxes

- Taxable Income: \$8,406
- Income Tax: \$841
- SE Tax: \$9,280
- Total Tax Liability: \$10,121

# Carryovers to 2021

- NOL:  $\$60,257 - \$33,624 = \$26,633$
- Qualified Business Net Loss Carryforward: \$0

# 2021

- Standard Deduction (\$12,600 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Depreciation left on truck tractor
- Post 2017 NOL: <\$>
  - Can only reduce 80% of income tax calculated without regard to NOL
  - Pre-NOL AGI: \$61,035 (\$65,675 less ½ SE Tax)
- QBI: \$65,675 - 0 = \$65,675
- QBID: 20% of \$65,675 or 20% of \$48,435
- QBID: \$9,687
- Taxable Income before NOL and QBID: \$61,035 less Standard Deduction less QBID
  - $\$61,035 - \$12,600 - \$0 = \$48,435$
- Taxable Income after QBID:  $(\$48,435 - \$9,687 = \$38,478) \times 20\% = \$11,845$

## 2021 taxes

- Taxable Income: \$11,845
- Income Tax: \$1,185
- SE Tax: \$9,280
- Total Tax Liability: \$10,465

# Carryover to 2022

- NOL:  $\$26,633 - \$26,633 = \$0$
- Qualified Business Net Loss Carryforward:  $\$0$

# 2022 Taxes

- Standard Deduction (\$12,800 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Depreciation left on truck tractor
- QBI: \$65,675
- QBID: 20% of \$65,675 or 20% of \$48,235
- QBID: \$9,647
- Taxable Income before QBID: \$61,035 less Standard Deduction less QBID
  - $\$61,035 - \$12,800 - \$0 = \$48,235$
- Taxable Income after QBID:  $\$48,235 - 9,647 = \$38,588$

## 2022 taxes

- Taxable Income: \$38,588
- Income Tax: \$4,439
- SE Tax: \$9,280
- Total Tax Liability: \$13,719

# Taxes 2018-2022

<b>Single Bonus Depreciation 100%</b>						
	2018	2019	2020	2021	2022	Total
Taxable Income	0	9767	8406	11845	38588	68606
Income Tax	0	977	841	1185	4439	7442
SE Tax	0	9280	9280	9280	9280	37120
<b>Total Tax</b>	0	10257	10121	10465	13719	<b>44562</b>

# NO Bonus Depreciation

- Truck Tractor is 3 yrs MACRS Property
  - Depreciation: \$55,000
  - Business Income: \$10,675
  - AGI: \$9,921
  - QBID: \$0
  - Taxable Income: \$0
  - Income Tax: \$0
  - SE Tax: \$1,508
  - Total Tax \$1,508
  - BUT for 2019...?
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# Carryovers to 2019

- Post 2017 NOL: \$0
- Qualified Business Income Deduction Carryforward: \$0

## 2019 – NOL Computation

- Standard Deduction (\$12,200 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- Year 2 Depreciation \$73,333
- QBI:  $\$65,675 + \langle \$73,333 \rangle = \langle \$7,658 \rangle$ 
  - QBID = \$0
- Taxable Income  $\langle \$19,458 \rangle$

# 2019 Taxes

- Taxable Income: \$0
- Income Tax: \$0
- SE Tax: \$0
- Total Tax Liability: \$0

# Carryovers to 2020

- NOL: \$7,658
- Qualified Business Net Loss Carryforward: <\$7,658>

# 2020 NOL Computation

- Standard Deduction (\$12,400 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Year 3 Depreciation: \$24,445
- Post 2017 NOL: <\$7,658>
  - Can only reduce 80% of income tax calculated without regard to NOL
  - Pre-NOL AGI: \$41,230 less ½ SE Tax = \$38,317
- QBI: \$41,230 - \$7,658 = \$33,572
- QBID: 20% of \$33,572 or 20% of \$25,917
- QBID: \$5,183
- Taxable Income before NOL and QBID: \$61,035 less Standard Deduction less QBID
  - $\$38,317 - 12,400 - \$0 = \$25,917$
- Taxable Income after QBID:  $\$25,917 - 5,183 = \$20,734$
- Taxable Income =  $\$20,734 - (80\% \text{ of } \$20,374 \text{ OR } \$7,658) = \$13,076$

# 2020 Taxes

- Taxable Income: \$13,076
- Income Tax: \$1,308
- SE Tax: \$5,826
- Total Tax Liability: \$7,134

# Carryovers to 2021

- NOL: \$0
- Qualified Business Net Loss Carryforward: \$0

# 2021

- Standard Deduction (\$12,600 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- Depreciation: \$12,222
- QBI:  $\$65,675 - \$12,222 = \$53,453$
- AGI: \$49,676 (\$53,453 less  $\frac{1}{2}$  SE Tax)
- Taxable before QBID  $\$49,676 - \$12,600 = \$37,076$
- QBID: 20% of \$53,453 or 20% of \$37,076
- QBID: \$7,415
- Taxable Income after QBID:  $\$37,076 - \$7,415 = \$29,661$

## 2021 taxes

- Taxable Income: \$29,661
- Income Tax: \$3,371
- SE Tax: \$7,553
- Total Tax Liability: \$10,924

# Carryover to 2022

- NOL: \$0
- Qualified Business Net Loss Carryforward: \$0

# 2022 Taxes

- Standard Deduction (\$12,800 tax free income)
- Profit BEFORE any depreciation Schedule C \$65,675
- No Depreciation left on truck tractor
- QBI: \$65,675
- AGI:  $\$65,675 - \frac{1}{2} \text{ SE Tax} = \$61,035$
- QBID: 20% of \$65,675 or 20% of \$48,235
- QBID: \$9,647
- Taxable Income after QBID:  $\$48,235 - \$9,647 = \$38,588$

## 2022 taxes

- Taxable Income: \$38,588
- Income Tax: \$4,439
- SE Tax: \$9,280
- Total Tax Liability: \$13,719

## 2018-2022 No Bonus Depreciation

Single Bonus Depreciation 0%						
	2018	2019	2020	2021	2022	Total
Taxable Income	0	0	13076	29661	38588	81325
Income Tax	0	0	1308	3371	4439	9118
SE Tax	1508	0	5826	7553	9280	24167
<b>Total Tax</b>	1508	0	7134	10924	13719	<b>33285</b>

# Comparison

## 100% Bonus

- Taxed Income: 68,606
- Income Tax: 7,442
- SE Tax: 37,120
- Total Taxes: 44,652

## No Bonus

- Taxed Income: 81,325
- Income Tax: 9,118
- SE Tax: 24,167
- Total Taxes: 33,285

**Savings: \$11,367 (25.4%)**

# What Else to Consider?

- Premium Tax Credits
  - Retirement funding
  - Section 179 – biggest difference? SE Tax savings
  - Elect into straight line
  - Elect 50% bonus
  - Additional Income from other sources
  - Incorporating the Business
  - Significant Itemized Deductions
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